

§ 5f.168(f)(8)–1 Questions and answers concerning transitional rules and related matters regarding certain safe harbor leases.

The following questions and answers concern the transitional rules and related matters regarding certain safe harbor leases under section 208(d) of the Tax Equity and Fiscal Responsibility Act of 1982 (Pub. L. 97–248) (“TEFRA”):

Q–1: If a lessee, prior to the period beginning after December 31, 1980, and ending before July 2, 1982 (the “window period”), enters into a binding contract to acquire property and the property is delivered to the lessee during the window period, is the property eligible for the transitional rule provided in section 208(d)(3) of TEFRA which applies the safe harbor leasing rules of section 168(f)(8) of the Internal Revenue Code of 1954 as in effect before the enactment of TEFRA?

A–1: Yes, assuming all other requirements of the TEFRA transitional rules are met. Section 208(d)(3)(A) (i) and (ii) of TEFRA provide alternative tests under which an item of property may constitute “transitional safe harbor lease property” for purposes of the transitional rules under the modifications to the safe harbor lease provisions of section 168(f)(8). The tests are:

- (i) The lease entered into a binding contract to acquire the property;
- (ii) The lessee entered into a binding contract to construct the property;
- (iii) The property was acquired by the lessee; or
- (iv) Construction of the property was commenced by or for the lessee.

These tests are stated in the alternative, and, accordingly, property may be eligible for pre-TEFRA safe harbor leasing if any one of the tests is satisfied. Thus, if a lessee acquired property during the window period, the property may be eligible for pre-TEFRA safe harbor leasing even though a binding contract to acquire the property was executed before the window period. Similarly, if construction of property commences during the window period, the property may be eligible for pre-TEFRA safe harbor leasing even though a binding contract to construct the property was executed before the window period.

Q–2: How do the transitional rules apply to components of an integrated manufacturing, production, or extraction process, none of which would be considered “placed in service” until all of the components are placed in service?

A–2: (i) The transitional rules regarding acquisition, binding contracts, and commencement of construction are applied to each separate item of property which is part of a manufacturing, production, or extraction

process. What constitutes a separate item will be determined on a case-by-case basis, taking into account all relevant factors. In general, a discrete component capable of performing a function which is separate from or in addition to the function of other components to which it may be related is a separate item of property; but an item that is integrated into a component which performs a function separate from other components to which it is related is not itself a separate item of property. For example, a bolt or a nut that is used to construct a machine does not constitute a separate item of property. On the other hand, the transitional rules will not be applied to an entire facility as a whole, as was the case under the investment tax credit transition rule of section 50 in *Hawaiian Independent Refinery, Inc. v. United States*, 49 AFTR 2d 675 (Ct. Cl. Tr. Judge 1982), where the taxpayer was held to have constructed a property which consisted of an entire refinery complex. Thus, for example, for purposes of these transitional rules, an oil or gas well, storage tanks, and pipeline located on a lease would not be considered a single item of property. Although each item is related to the production of oil or gas, each is discrete and each is capable of performing a separate function from the other. In addition, in the case of an integrated manufacturing, production, or extraction process, commencement of construction of one item of property within the process would not be considered construction of any other item of property that is part of the process.

(ii) If property qualifies as transitional safe harbor lease property, all direct and indirect costs allocable to the property (except for those described in § 5c.168(f)(8)–6(a)(2)(ii)) and required to be capitalized for Federal income tax purposes will also qualify as transitional safe harbor lease property to the extent such costs are incurred on or before the date on which the property is leased under section 168(f)(8).

(iii) The adjusted basis to the lessor of property leased on or prior to December 1, 1982, under a transitional safe harbor lease shall be deemed to include all direct and indirect costs (including installation costs) described in subdivision (ii) allocable to such property that were incurred before it was leased despite the fact that such costs were not included in the lessor’s adjusted basis of such property under the terms of the lease agreement, provided that the parties to such agreement reasonably believed that they had leased the whole of such property. Such costs will be treated as having been included in the lessor’s adjusted basis of such safe harbor lease property on the date the lease agreement was executed without regard to any provisions in the lease agreement that limits the dollar amount of the permissible adjustment of the lessor’s adjusted basis to such property. To qualify for inclusion of

such direct and indirect costs within the basis of such property, the parties to such agreement must file an amended Form 6793, the Safe Harbor Lease Information Return, no later than April 21, 1983, which reflects the parties' intent to include installation and other such costs within the basis of such property. For purposes of this subdivision, a transitional safe harbor lease is a lease either which was executed after July 1, 1982, and on or prior to December 1, 1982, or which includes some transitional safe harbor lease property, as defined in TEFRA section 208(d)(3), that was placed in service after July 1, 1982, and on or prior to December 1, 1982.

Q-3: What test will be applied in determining whether an item of property is constructed or acquired by the lessee?

A-3: Except as expressly provided in section 208(d)(3) (D) or (E) of TEFRA, the determination of whether and when any such events occurred with respect to an item of property will generally be made in accordance with the principles and precedents prior to TEFRA under the investment tax credit and depreciation allowance transitional provisions. See §§1.48-2(b)(6) and 1.167(c)-1(a)(2), which provide definitions of the term "acquired", and §§1.48-2(b)(1) and 1.167(c)-1(a)(1), which provide definitions of the term "constructed by". Also see Rev. Rul. 80-312, 1980-2 C.B. 21, which discusses the factors to be considered in determining when a taxpayer has control over a project being constructed.

In general, for purposes of TEFRA section 208(d)(3), construction of an item of property is considered to have commenced when physical work of a significant nature has begun with respect to the property. Thus, construction does not begin when parts or components which enter into construction are acquired. If property is assembled from purchased parts or components, the commencement of construction occurs when actual assembly of the property begins. If a taxpayer manufactures a major part or component of an item of property for itself, construction will be considered to have begun when the manufacturing of that part or component commences. However, construction of an item of property will not be considered as begun if physical work by the taxpayer relates to minor parts or components. Clearing and grading of land will be considered in determining when construction begins on an item of property only if they are directly associated with the construction of the property.

Q-4: Under section 168(f)(8)(J), the at-risk rules are liberalized for closely held lessors that engage in safe harbor leasing. These rules apply "in the case of property placed in service after the date of enactment of this subparagraph," namely, after September 3, 1982.

Do the liberalized at-risk rules apply in the case where otherwise qualified property is

placed in service by a lessee in August of 1982 but is leased by a corporate lessor subject to the at-risk rules after September 3, 1982?

A-4: The liberalized at-risk rule in section 168 (f)(8)(J) is applicable in this case because, in determining whether property is placed in service before or after the date of enactment of section 168(f)(8)(J), the relevant date is the date the property is placed in service by the lessor. Additionally, a closely held corporate lessor, which is not a personal service corporation, may lease transitional safe harbor lease property placed in service after September 3, 1982, under the liberalized at-risk rule.

Q-5: Is it necessary for property placed in service by a lessee in December of 1982 to be leased before January 1, 1983, in order to qualify under the general transitional rule of section 208(d)(3)(A) of TEFRA, which requires that the property be placed in service before January 1, 1983?

A-5: The legislative intent of this transitional rule was to provide a 3-month period after property is placed in service by a lessee in which a safe harbor lease could be entered into. *Cf.* section 209(c) of TEFRA (3-month window applies to true leases entered into after 1983). The legislative intent further was to permit property to qualify as transitional safe harbor lease property if it was placed in service by the end of 1982 by a lessee. Accordingly, transitional safe harbor lease property placed in service in 1982 by a lessee may be leased in a safe harbor lease transaction within 3 months after it is placed in service by the lessee without losing its status as transitional safe harbor lease property.

However, for all other purposes of the Code other than section 168(f)(8)(D)(i), section 168(f)(8)(D)(viii)(II) will apply and the property will be treated as originally placed in service not earlier than the date that the property is used under the lease. Thus, for example, if transitional safe harbor lease property is placed in service in December of 1982 and leased under section 168(f)(8) in January of 1983, the property will not lose its status as transitional safe harbor lease property, but the basis adjustment rules of section 48(g) will apply with respect to the property.

Q-6: Will a contract to acquire property be considered "binding" for purposes of section 208(d)(3)(A)(i) of TEFRA if the contract contains no liquidated damages clause?

A-6: Generally, an irrevocable contract which contains no provision for liquidated damages in the event of breach or cancellation would be considered binding. Moreover, in determining the amount of the lessee's potential liability, the fair market value of the property will not be taken into account. For example, if a lessee entered into an irrevocable contract to purchase an asset for \$100 and the contract contained no provision for liquidated damages, the contract would be

considered binding notwithstanding the fact that the property at all times after July 1, 1982, had a value of \$99 and under local law the seller could only recover the difference in the event the lessee failed to perform. On the other hand, if the contract by its terms provided for liquidated damages of less than 5 percent of the purchase price which is in lieu of any damages allowable by law, in the event of breach or cancellation, the contract would not be considered binding.

Q-7: How does the 50-percent limitation on lessors in section 168(i)(1) and the 45-percent limitation on lessees in section 168(f)(8)(D)(ii) apply to corporations which are part of an affiliated group filing consolidated returns?

A-7: Both the 50-percent limitation on lessors and the 45-percent limitation on lessees will be applied on a consolidated basis for corporations filing consolidated returns.

Q-8: Section 168(f)(8)(J) liberalized the at-risk rules for safe harbor leasing and provides that in cases where the safe harbor lessee would be considered the owner of the property without regard to the safe harbor lease, the lessor is considered to be at risk with respect to the property in an amount equal to the amount the lessee is considered at risk with respect to such property as determined under section 465.

Will a corporate lessor that would ordinarily be subject to the at-risk rules under section 465 be exempt from such rules under section 168(f)(8)(J) in a situation where acquisition of the leased property is financed with non-recourse debt by a lessee that is not subject to the at-risk rules?

A-8: Yes. The liberalized at-risk rules of section 168(f)(8)(J) will apply in cases where the lessee's ACRS deductions and investment tax credit with respect to the property would not have been limited under the at-risk rules had the parties not elected treatment under section 168(f)(8).

Q-9: Section 168(f)(8)(J)(ii) excepts certain service corporations from the liberalized at-risk rules of section 168(f)(8)(J)(i). Does the exception in subdivision (ii) also extend to subsidiaries of such service corporations that file consolidated returns?

A-9: Yes. The liberalized at-risk rules of section 168(f)(8)(J)(i) will not apply to any subsidiary filing a consolidated return with a service organization described in section 168(f)(8)(J)(ii).

Q-10: Will property lose its status as transitional safe harbor lease property under section 208(d)(3) of TEFRA solely by reason of the fact that the person who is a party to a binding contract to acquire the property assigns his rights in the contract to another person?

A-10: When a person who is a party to a binding contract transfers his rights in the contract (or the property covered by the contract) to another person and the transferor (or a corporation which is a member of the same affiliated group as the transferor) will use the property under a lease for a period

not less than 50 percent of the appropriate recovery period for the leased property under section 168(c), then to the extent of the transferred rights, this other person will succeed to the position of the transferor with respect to the binding contract and the property. Accordingly, under these circumstances, property will not lose its status as transitional safe harbor lease property.

In addition, property will not be disqualified as transitional safe harbor lease property solely by reason of a transfer by a person of his rights in a contract (or the property covered by the contract) in a transaction in which the basis of the property in the hands of the transferee is determined by reference to its basis in the hands of the transferor (e.g., transfers governed by sections 332, 351, 361, 721, and 731). Thus, for example, if a corporation entered into a binding contract for the construction or acquisition of property prior to July 1, 1982, and after such date assigned the contract to a corporation within the same affiliated group which files consolidated returns, the assignee will be entitled to treat the property acquired pursuant to the contract as transitional safe harbor lease property, assuming the property would have so qualified in the hands of the transferor. Similarly, if a joint venture or partnership between two corporations entered into a binding contract or commenced construction of property before July 2, 1982, but dissolved and distributed its assets to the partners or joint venturers after July 2, 1982, the joint venturers or partners may treat the assets as transitional safe harbor lease property, assuming the property would have so qualified had the joint venture or partnership remained in existence.

Q-11: During 1982, Corporation Y placed in service section 38 property with a total cost of \$100X. On August 15, 1982, Corporation Y placed in service the last component of an entire facility within the meaning of § 5c.168(f)(8)-6(b)(2). The facility had a total cost basis of \$40X, of which \$30X was transitional safe harbor lease property within the meaning of section 208(d)(3) of TEFRA and \$10X was not transitional safe harbor lease property. On November 1, 1982, Corporation Y sold and leased back under a section 168(f)(8) lease the \$30X of transitional safe harbor lease property in the facility.

Will the entire facility rule in § 5c.168(f)(8)-6(b)(2) apply in this situation where the taxpayer has not leased all of the section 38 property in the facility?

A-11: No. The placed in service date, for purposes of the rule requiring that property be leased within 3 months after such property was placed in service by the lessee, would be determined under the entire facility rule in § 5c.168(f)(8)-6(b)(2) only if Corporation Y had leased all the qualified leased property in the facility. Since Corporation Y leased only the \$30X of transitional section

38 property, of the facility and did not lease the § 5c.168(f)(8)–6(b)(2) property, Corporation Y may not rely on the entire facility rule of § 5c.168(f)(8)–6(b)(2) for purposes of determining the placed in service date for the property under the section 168(f)(8) lease.

Q–12: Assume the same facts as in Q–11, except that Corporation Y had also placed in service by August 15, 1982, § 30X of miscellaneous machinery and equipment all of which was transitional safe harbor lease property within the meaning of section 208(d)(3) of TEFRA. On November 1, 1982, in addition to the § 30X of transitional property in the facility, Corporation Y also sold and leased back under a separate section 168(f)(8) lease the § 30X of miscellaneous machinery and equipment.

Will the entire facility rule in § 5c.168(f)(8)–6(b)(2) apply in this situation to the § 30X of transitional property in the facility?

A–12: Yes. Since Corporation Y leased § 30X of transitional machinery and equipment and the § 30X of the facility which consisted of transitional property, Corporation Y can lease none of the nontransitional property in the facility because, by reason of the 45-percent cap on lessees contained in section 168(f)(8)(D) (ii) and (iii) and (I), it is not qualified leased property for purposes of section 168(f)(8). Thus, on the facts, Corporation Y has leased all the qualified leased property in the facility.

Q–13: Corporation X constructed a manufacturing complex consisting of three integrated operational components, each with a different ADR present class life midpoint, which together constitute an “entire facility” within the meaning of § 5c.168(f)(8)–6(b)(2). The last components of the facility were placed in service on August 15, 1982. On October 1, 1982, Corporation X sold to Corporation Z and leased back under section 168(f)(8) all the qualified leased property of the facility.

For purposes of the rule requiring that property be leased within 3 months after such property was placed in service by the lessee, will the leased components of the entire facility be considered placed in service by the lessee on August 15, 1982, the date the last components were placed in service, if the components are leased at one time pursuant to documents consisting of three section 168(f)(8) leases with different terms to reflect the different ADR midpoint lives of the qualified leased property in the facility?

A–13: Yes. If the entire facility rule in § 5c.168(f)(8)–6(b)(2) applies, the facility components which were placed in service prior to August 15, 1982, will be treated as placed in service by the lessee on August 15, 1982, for purposes of the 3-month rule. This rule will apply if all the qualified leased property of the facility is leased at one time. The documentation may be in the form of multiple, simultaneously executed agreements or maybe in the form of an agreement comprised of one or more parts or schedules. Each of the multiple agreements, or each of

the parts or schedules of an agreement, may have different lease terms for property with different ADR midpoint lives, so long as each such agreement or part of schedule individually would be treated as a lease under section 168(f)(8), taking into account the entire facility rule, with lease terms commencing on the same date. A single transaction effected by multiple agreements or by an agreement with one or more parts or schedules will meet the maximum lease term requirement of § 5c.168(f)(8)–5(b) so long as each agreement or each part or schedule of an agreement meets the maximum lease term requirement.

Q–14: Under § 5c.168(f)(8)–6(b)(2), the special rule for facilities applies only if the entire facility is leased under a section 168(f)(8) lease.

Will a transaction not qualify under section 168(f)(8) if the parties, acting in good faith, omit an insubstantial portion of the qualified lease property from the lease?

A–14: No. The facility rule of § 5c.168(f)(8)–6(b)(2) will apply if the parties, acting in good faith, substantially comply with its terms.

Q–15: When will construction of an aircraft be considered to have been begun after June 25, 1981, and before February 20, 1982, for purposes of TEFRA section 208(d)(3)(D)?

A–15: Construction of an aircraft will be considered to have been begun after June 25, 1981, and before February 20, 1982, if during such period any of the following events occurred:

- (i) Construction or reconstruction of a sub-assembly designated for the aircraft was commenced;
- (ii) Construction of a lot increment of sub-assemblies (one or more of which was designated for the aircraft) was commenced; or
- (iii) The stub wing join occurred.

Q–16: Does the definition of assets used in the manufacture or production of steel for purposes of TEFRA section 208(d)(2)(F) include all assets used in this function (such as electrical and steam generators and distribution equipment, coke oven by-product equipment) although not necessarily includible in the former ADR guideline class for primary steel mill products?

A–16: Yes, all assets that are used, in their primary function, as an integral part of the steel manufacturing or production process are included. Cf. § 1.48–1(d)(4). However, the steel manufacturing or production process does not include processing beyond the production of primary ferrous metals (as defined by the ADR Class for Manufacture of Primary Ferrous Metals).

Q–17: Where a qualified mass commuting vehicle meets the requirements for both the TEFRA section 208(d)(2) transitional rule and the TEFRA section 208(d)(5) special rule for mass commuting vehicles, which provision will control?

A–17: The general transitional rule of TEFRA section 208(d)(2) will apply. Thus,

pursuant to TEFRA section 208(d)(2)(B), the provisions of section 168(f)(8)(J), but not the provisions of section 168(i)(1), will apply only to such property. If the general transitional rule does not apply to a specific mass commuting vehicle, the provision of section 168(i)(1) applies to the lessor who leases such vehicle.

Q-18: Does the definition of a qualified mass commuting vehicle include component parts of a qualified mass commuting vehicle—such as an undercarriage of a subway car or the costs of rehabilitation or reconstruction of a mass commuting vehicle (or component part thereof)?

A-18: Yes.

[T.D. 7850, 47 FR 50853, Nov. 10, 1982, as amended by T.D. 7879, 48 FR 11942, Mar. 22, 1983]

PART 6a—TEMPORARY REGULATIONS UNDER TITLE II OF THE OMNIBUS RECONCILIATION ACT OF 1980

Sec.

6a.103A-1 Interest on mortgage subsidy bonds.

6a.103A-2 Qualified mortgage bond.

6a.103A-3 Qualified veterans' mortgage bonds.

6a.6652(g)-1 Failure to make return or furnish statement required under section 6039C.

AUTHORITY: 26 U.S.C. 7805.

Sections 6a.103A-2(k), (l), and (m) also issued under 26 U.S.C. 103A(j) (3), (4), and (5).

§ 6a.103A-1 Interest on mortgage subsidy bonds.

(a) *In general*—(1) *Mortgage subsidy bond*. A mortgage subsidy bond shall be treated as an obligation not described in section 103 (a)(1) or (a)(2). Thus, the interest on a mortgage subsidy bond is includable in gross income and subject to Federal income taxation.

(2) *Exceptions*. Any qualified mortgage bond and any qualified veterans' mortgage bond shall not be treated as a mortgage subsidy bond. See § 6a.103A-2 with respect to requirements of qualified mortgage bonds and § 6a.103A-3 with respect to requirements of qualified veterans' mortgage bonds.

(3) *Additional requirement*. In addition to the requirements of § 6a.103A-2, § 6a.103A-3, and this section, qualified mortgage bonds and qualified veterans' mortgage bonds shall be subject to the requirements of section 103(c) and the regulations thereunder.

(4) *Advance refunding*. On or after December 5, 1980, no tax-exempt obligation may be issued for the advance refunding of a mortgage subsidy bond (determined without regard to section 103A(b)(2) or § 6a.103A-1(a)(2)). An obligation issued for the refunding of a mortgage subsidy bond will be considered to be an advance refunding obligation if it is issued more than 180 days before the prior issue is discharged.

(5) *Registration*. Any obligation that is part of a qualified mortgage bond issue or qualified veterans' mortgage bond issue and which is issued after December 31, 1981, must be in registered form. The term "in registered form" has the same meaning as in § 1.6049-2(d). Thus, in general, an obligation is issued in registered form if it is registered as to both principal and interest and if its transfer must be effected by the surrender of the old instrument to the issuer and by either the reissuance of the old instrument to a new holder or the issuance of a new instrument to a new holder.

(b) *Definitions*. For purposes of §§ 6a.103A-2, 6a.103A-3, and this section the following definitions apply:

(1) *Mortgage subsidy bond*. (i) The term "mortgage subsidy bond" means any obligation which is issued as part of an issue a significant portion of the proceeds of which is to be used directly or indirectly to provide mortgages on owner-occupied residences.

(ii) For purposes of subdivision (i), a significant portion of the proceeds of an issue is used to provide mortgages if 5 percent or more of the proceeds are so used.

(2) *Mortgage*. The term "mortgage" includes deeds of trust, conditional sales contracts, pledges, agreements to hold title in escrow, and any other form of owner financing.

(3) *Bond*. The term "bond" means any obligation. The term "obligation" means any evidence of indebtedness.

(4) *State*. (i) The term "State" includes a possession of the United States and the District of Columbia.

(ii) For purposes of subdivision (i), obligations issued by or on behalf of any State or local governmental unit by constituted authorities empowered